CIA/OER/S-05677A-73
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Approved For Release 2006/09/26 : CIA-RDP85T00875R001900010023-2

CIA/OER/S-05680-73 MICHAEL KASER'S ARTICLE ON SOVIET BALANCE OF PAYMENTS

12 DECEMBER 1973 UNCLASSIFIED

S-5680

CIA/OER/S-05680-73

12 DEC 1973

[redacted]

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MEMORANDUM FOR: Mr. Raymond J. Albright
Vice President, Planning and Research Division
Export-Import Bank
Washington, D.C. 20571

SUBJECT : Michael Kaser's Article on Soviet Balance of Payments

[redacted]

The attached is responsive to your request for our comments on Michael Kaser's article in a recent issue of the International Currency Review. We have already made oral comments to Margaret Dray of your office, some of which were incorporated in her analysis. As you know, we are updating our estimates of Soviet debt which will be forwarded to you by the end of the month. If we can be of further assistance in this matter, please do not hesitate to call on us.

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MAURICE C. ERNST
Director
Economic Research

Attachment:
As stated

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Highlights

The combination of errors and questionable methodology leads to conclusions regarding current and future Soviet indebtedness which are believed to be invalid. Some of the more serious shortcomings of Kaser's analysis are as follows:

1. The Soviet debt figure in 1971 is double what it should be. The source which Kaser cites gave the number as $4 billion including the USSR and Eastern Europe and not just the USSR. Using Kaser's methodology but a more accurate figure of $2 billion for Soviet debt, Soviet indebtedness would come to about $4.5 billion for 1975 and roughly $12 billion for 1980 instead of $10 billion and $26 billion respectively.

2. Kaser calculates new debt as the current year's deficit plus annual debt service. This methodology may have merits, but it ignores the realities of Soviet debt management. By debt service Kaser means payments of interest only. Debt service (interest only) would take almost half of Soviet exports projected for 1980. This is clearly an excessive figure and would not be tolerated by Soviet authorities.

3. Kaser calculates the invisible deficit at $560 million in 1971, growing to $1.2 billion by 1980. Except for 1973 when ship chartering expenditures were abnormally high, the Soviet invisibles account has been roughly in balance since 1970 and should be in surplus by 1975 or possibly next year.

4. Kaser's calculations on gold reserves and sales show some lack of clarity and at least one major error, e.g., the gold stock is understated in 1973 by more than $1 billion. One is also left to estimate (or go to another source) to determine what gold production is from his statements.

In 1980 he shows sales of $700 million (242 tons at $90 per ounce) with a deficit of $3.2 billion and an accumulated debt of more than $26 billion, but projects sales of $885 million (more than 300 tons) in 1975 in 1975 when the deficit is shown as only $2 billion and indebtedness as $10 billion. This seems to be predicated on his argument that the USSR will sell less gold by 1980 and will not let reserves fall below 1,600 tons. But his table shows gold reserves in 1980 at almost 1,800 tons.

In summary, we believe that Mr. Kaser's article is of little use to anyone desiring to judge the USSR's credit-worthiness. His methodology indicates that he is not familiar with the manner in which the USSR finances its deficits. His estimates on invisibles show a lack of familiarity with the elements which go to make up the hard currency invisibles account, especially transportation and tourism. His errors throughout the piece, moreover, indicate some carelessness in compiling the table and accompanying explanations.

Comments on Text

Kaser's article on Soviet balance of payments is not the first article ever to be published on the subject. Marcella Caiola prepared some quite extensive papers on the Soviet balance of payments that were published in IMF Staff Papers in March 1962 (covering the years 1955-58) and in the JEC's Dimensions of Soviet Economic Power in December 1972 (covering the years 1959-60).

Para. 1: Kaser apparently assumes that hard currency countries are identical to the Soviet concept of "industrially developed capitalist countries." The latter category includes Finland and Greece, with which the USSR trades on a barter basis, and excludes the LDCs with which the USSR trades on a hard currency basis. The figures for exports and imports for 1971-1973 and hence the deficits are consequently incorrect.

Kaser's estimates for invisible transactions are puzzling. An estimate of $560 million for 1971 rising to a $1.2 billion level by 1980 seems far out of line. This is a major flaw in his balance of payments model that by itself produces a cumulative invisible deficit of $8 billion for 1971-80, which Kaser says must be covered by borrowing. With the exception of 1973, when the Soviets have had to spend significant amounts of hard currency for chartering vessels to carry grain, the transportation account is in surplus. Kaser himself says that Soviet freight earnings will begin to yield significant offsetting income, but he estimates the invisible deficit at a constant 19% of imports every year through 1980.

Since 1970 (except for 1973) invisibles are estimated to be essentially in balance and will probably be in surplus by 1975 or even in 1974. Revenues from tourism, transportation and other elements will probably offset interest payments and other expenditures.

Para. 2: Kaser errs when he says that the USSR reacted to the hard currency problem by cutting back on imports of machinery and equipment from the West. On the contrary, imports of machinery and equipment from hard currency countries increased 33% to a record high of $1.3 billion in 1972 and will rise to at least $1.5 billion in 1973. It is true that imports of machinery and equipment from six countries fell in 1972, but imports from another nine increased to more than offset the decline. New contracts for machinery and equipment were substantially higher in 1972 than in 1971 and will be higher yet in 1973.

Para. 3: Kaser correctly observes the omission of statistics on grain trade. In regard to Soviet imports of crude oil from Iraq and Libya, however, it is by no means clear that hard currency was not involved.

Para. 4: The discussion of US trade statistics and US exports of grain seems to add little to the article. His estimates of US exports of $700 million in grain to the USSR in 1973 is in any case, too low.

Para. 5: Kaser suggests that the 4% growth in 1972 in Soviet exports to hard currency trading partners (actually 6%) will not be exceeded by much during the remainder of the decade using the standard argument of noncompetitive Soviet manufactures. He believes, however, that MFN would help the USSR "do much better" in the US market. We believe MFN will do little for the Soviets.

Para. 6: Kaser suggests the possibility of expanded Soviet exports to help offset the energy deficit in the US, but counters this by citing an article of his -- as yet unpublished -- indicating that Soviet exports of crude oil to non-CEMA countries will not increase in the 1970s.

Para. 7: See comments on table and notes.

Para. 8: Japan has not provided a $300 million credit for the reconstruction of Pacific port facilities. The project Kaser apparently has in mind is the development of a port at Wrangel Bay, the total cost of which is put at more than $300 million. The Japanese are providing an $80 million credit to finance Soviet imports of machinery and equipment for the project.

Para. 9: No comment.

Para. 10: No comment.

Para. 11: According to Kaser, his most "hazardous of the postulates for the present exercise" is the belief that Soviet planners will not allow their gold reserves to fall below 1,600 tons after 1980. This postulate, however, is not unreasonable, although reserves could be allowed to fall well below that. Because of increases in the price of gold in recent years, Kaser speculates that the USSR probably transferred some of the incremental holdings to the CEMA banks citing as evidence the bank's increased hard currency loans to other CEMA countries. The reasoning is difficult to comprehend.

Para. 12: Kaser's estimates on the interest rates that the USSR must pay are somewhat high. Most of the USSR's medium and long-term indebtedness is backed by Western government guarantees which call for about 6% interest. Probably 90% of the USSR's 1971 indebtedness was made up of government-backed credits. If the balance was financed on the open market at rates as high as 12%, the composite rate for the entire indebtedness would be less than 7%. He raises the rate for 1974-75 to 8-8½% and drops it to 7½% in 1977-80, with no reasons given.

Para. 13, 14: See comments on table and notes.

Para. 15: All other things being equal, it is highly unlikely that Western bankers would consider the USSR to be a good credit risk if interest payments on accumulated debt -- Kaser's interpretation of "debt service payments" -- amounted to 49% of its hard-currency export earnings.

Comments on Table and Notes

Line 1.1: Computation of total Soviet gold reserves at free market prices is questionable. In the unlikely event that all Soviet gold were sold in a given year, the price would decline sharply. The assumption that the price of gold will average about $90 per ounce from 1973 to 1980 is also debatable.

The estimate of gold reserves in 1973 is inconsistent with Kaser's methodology. A gold stock of $4,255 million translates into 1,470 tons at $90 per ounce. In 1972 the gold stock of $3,370 million at $58 per ounce implies a stock of 1,810 tons. But according to Kaser, $325 million was sold in 1972 (174 tons). Even if no gold were produced or consumed in the USSR in 1972, there would still be 1,635 tons left and at $90 per ounce, the reserves would be $4,735 million, and not $4,255 million. But Kaser states in another article that net output in 1972 was 173 tons. Thus in 1973 gold stocks should be calculated at 1,809 tons or $5,237 million at $90 an ounce.

Line 1.2: Estimates of convertible currency reserves at 5% seems much too low. This office believes that reserves are at a minimum of 10% of the annual hard currency import bill and probably higher. Our estimate includes the reserves of the Soviet banks abroad.

Line 1.3: No comment

Line 2.1: Kaser misquotes the Financial Times source. The debt referred to in the source includes Eastern Europe as well. The Kaser estimate is wrong by about 100%. The Soviet debt is closer to $2 billion. Thus, the projections compound the original error.

Line 2.2: Kaser calculates indebtedness as the "present backlog of commercial credit which is assumed to be rolled over as it matures," while new debt "consists of the balance of payments deficit plus debt servicing." The expression "rolled over" is confusing. Most Soviet borrowing is long-term and normally is not rolled over. Short-term credits are either repaid on maturity or rolled over, but they are not automatically rolled over and accumulated as Kaser indicates. A little research would demonstrate that most Soviet borrowing does not correlate with annual current account deficits.

Line 2.3: Debt service according to Kaser is comprised wholly of interest payments. Under his formula, payments on principal evidently are not considered as part of debt service apparently because principal is not paid but rolled over. His estimates of interest charges are also a little high.

Line 2.4: Gold sales appear to be in line through 1973. His estimates for future years appear consistent with what he projects in deficits. But the decline in sales by 1980 when he shows a deficit higher than any previous year seems odd. It would leave the USSR with more than his magic reserve figure of 1,600 tons of gold that he claims that the USSR will want to maintain.

Line 3.1: Imports for 1973 are estimated about $1 billion too low. Growth of imports at 5+% annual average is probably too low.

Line 3.2: Growth of exports from 1972 at average annual rate of less than 5% seems low.

Line 3.3: Visible deficit is too low for 1973.

Line 3.4: These estimates of the invisible deficit are far out of line. They are calculated at about 19% of the value of imports. In fact, it is estimated that except for 1973 when the USSR has had to spend considerable money to charter bottoms for grain, the USSR has been in surplus in its transportation account since 1970. Overall invisibles are estimated to more or less offset one another (tourist revenues plus other revenues, such as remittances are offset by interest outlays and other expenditures. For the period 1971-1980 Kaser thus implies an cumulative invisible deficit of more than $8 billion! And this figure does not even include interest payments.

Line 4.1: Allocation to reserve. No comment.

Line 4.2: Increase in indebtedness. Derived from Line 2.1.

Line 4.3: Lend-lease payments. Figures are incorrect for 1971-1972.

Line 4.4: Convertible element in development loans. No comment.

Line 4.5: Addition of lines 4.1 to 4.4.